Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of:	)	
	)	
Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	)	CC Dkt. No. 96-98 (Phase 1)

To: The Commission

REPLY COMMENTS OF THE SOUTHERN NEW ENGLAND TELEPHONE COMPANY

by

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SUMMARY

Several States have taken the initiative to open their exchange markets to competition prior to enactment of the Telecommunications Act of 1996. These States, such as Connecticut, have analyzed the very same issues and discussed and debated the alternative outcomes. It is on these experiences that the Commission should rely. The Connecticut experience offers the Commission an opportunity to examine the implications of national guidelines, and to assess how States have chosen to deal with similar issues. The Connecticut Department of Public Utility Control ("DPUC") has dealt with the key issues necessary for competition, understands the ramifications of its new policies, and has attempted to balance the new competitive landscape. Pursuant to Connecticut Public Act 94-83 that mandated competition within Connecticut, the DPUC has delivered on its responsibility to implement the spirit of both the Connecticut Public Act and the Telecommunications Act of 1996 ("Act").

In these Reply Comments, SNET focuses on five basic points that are critical to the continued implementation of effective local exchange competition in Connecticut:

(1) States, like Connecticut, have taken the initiative to introduce local competition prior to the Act taking effect. The Commission should provide broad guidelines that allow States to implement the Act's detailed directives, and should insure that those guidelines do not require State commissions to revise pro-competitive policies already in place;

(2) The Commission should establish TSLRIC as the price floor for unbundled network elements and interconnection arrangements, but it also should make clear

that a LEC also has a right to be reasonably compensated for common costs in its interconnection and unbundled network element prices;

(3) The Commission should provide guidelines to the States' in determining whether an exemption from specific requirements is warranted under the provision that authorizes the States to grant such exemptions to small and mid-size LECs;

(4) Existing interstate access charges should not be circumvented by rules that address opening exchange markets to competition.

(5) States should be allowed to determine reasonable restrictions on the retail services offered at wholesale prices. It is anticompetitive to require the availability to resellers at wholesale prices of product packages or promotional discounts;

States are in the best position to ensure that the Act is implemented

The Commission is faced with an overwhelming number of issues and potential outcomes that will have major ramifications for telecommunications consumers.

CLECs want "one-size-fits-all" regulation . . . but the shoe won't fit . . . the local market, by definition, varies, often radically, from state to state. New entrants are eager to enter a market that will complete their full service offerings but are reluctant to assume the burdens that accompany that entry. The local market, for which there are many viable competitors, has a regulatory history that cannot be ignored. For example, some States have rebalanced their local exchange rates and some have not, some have primarily measured service local rates, some have only flat rates, and most have some form of explicit subsidies. The Act is not clear as to how these historical mechanisms should be reformed to ensure that the incumbent LEC is not penalized

unfairly as competition evolves. Because local competition is the focus of the Act's interconnection, unbundling, and resale requirements, State regulatory commissions are the appropriate forums for much of the debate.

The Commission should establish TSLRIC as a price floor.

Just as incumbent LECs have a responsibility to open their networks to competitors, competitors also have a responsibility to contribute to the recovery of the costs necessary to provide network elements, interconnection arrangements, and wholesale provisioning. To assume that the incumbent should solely incur these costs when the CLEC is clearly the beneficiary is unreasonable. The Commission should establish a methodology which utilizes TSLRIC as a price floor and allow the states to determine the manner in which common costs will be recovered. The States are in the best position to determine the appropriate costs which should be considered and the level of costs which should be included in any cost recovery mechanism.

SNET agrees with USTA that although an incumbent LEC may avoid costs when it no longer provides the retail product, it does incur other costs to resell the service. It is only reasonable that the incumbent LEC be allowed to recover in its wholesale price to resellers the additional cost of providing the service on a wholesale basis.

The Act may disadvantage small and mid size companies

The Commission should clarify the States' authority to implement the Act's provision giving States power to address the

needs of small and mid-size LECs. This provision recognizes that these LECs may be disadvantaged by certain provisions of the Act and that State commissions are in the best position to determine whether relief for these companies is thus justified.

Access rules must not be circumvented

Clearly the intent of Section 251 of the Act is not to replace or negate the current access charge rules. SNET agrees that access service pricing must be reformed to avoid arbitrage between interconnection and access rates. The implicit subsidies contained in access rates must be addressed to prevent uneconomic pricing signals to CLECs.

It is anticompetitive to require LECs to provide retail service packages or promotional discounts at a wholesale rate for resale

As CLECs enter the local exchange market, they seek to ensure that customers do not perceive any difference in the quality of service provided by carriers. The Commission should define what is necessary to promote competition and what will inhibit competition between providers. While a customer may not perceive a difference in service installation or quality of transmission for resold services, the customer will perceive a difference in the service treatment by customer contact personnel, by differences in product offerings, and by differences in pricing. These are the elements of a competitive market. The Commission should take care not to limit the effectiveness of valid marketing strategies for differentiating service offerings, thereby limiting competition. For example, CLECs suggest that LECs should be obligated to provide

them with promotions and discount offers at a wholesale price for resale to consumers. Such a policy will stifle creativity by negating valid marketing strategies. This, in turn, will limit the availability of new services to the consumer, an outcome not consistent with the Act. However, the Commission can ensure that a CLEC has an ability to create its own package and discount offers by requiring the components of such package to be made available to a CLEC under the Act's resale provision.

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SNET submits this Reply in order to comment on five issues discussed by parties in their initial comments.

I. The Commission Should Provide Guidelines that Allow States Significant Latitude In Implementing a Competitive Local Market

As a preliminary matter, local markets are fraught with regulatory history that cannot be ignored. While the Commission has an obligation under the Act to establish national standards to encourage competition, those standards need only serve as enablers to competition, not as detailed prescriptions. Detailed Federal rules would hamstring State regulators in managing complex local issues. For example, detailed pricing requirements for interconnection and unbundled network elements, if mandated by the FCC, would prevent State regulators from fashioning solutions that account for local conditions. In the area of service quality standards, historically the province of State commissions, a "one-size-fits-all" Federal rule would not work because local markets vary, often radically, from state to state.

Those who ask the Commission to adopt rules which substantially eliminate the discretion of State regulators to implement Sections 251 and 252 make several arguments to support their plea. But their arguments are misplaced as we show below.

For example, AT&T contends that Section 251(d) of the Act requires that the FCC adopt such detailed rules merely because that provision instructs the Commission to "complete all actions necessary to establish regulations" by August 8, 1996.[1/] In fact, the language AT&T cites was included in Section 251(d) merely to make clear that the Commission must adopt whatever rules it chooses by the August 8 deadline rather than to require that the FCC's regulations substantially remove State regulator discretion.

If anything, Section 251(d) instructs the Commission to grant significant deference to State regulators in adopting rules to implement Sections 251 and 252 by holding that the FCC may preclude enforcement of any State policy only if the subject State policy "substantially prevent[s] implementation of the requirements of Sections 251 and 252." Had Congress intended for the Commission to preclude State flexibility to interpret these provisions in a way that best meets local conditions, it would have instructed the FCC to preempt enforcement of any State policy that is inconsistent with an FCC rule, rather than instructing the Commission to preempt enforcement of a State policy only if that policy substantially prevents implementation of the statute.

1/ AT&T Comments at 4.

AT&T and the Justice Department also are wrong when they argue that LECs have no incentive to negotiate interconnection arrangements which are consistent with Sections 251 and 252 in the absence of detailed Federal rules.[2/] In fact, both the plain language of Sections 251 and 252 and State implementation of that language provide a significant incentive for LECs to negotiate interconnection arrangements. Moreover, the evidence confirms that the incentive created by this language is working. Some LECs have already completed interconnection agreements with competitors, and others, such as SNET, have in place stipulated LEC/CLEC agreements approved by their State regulatory commissions.

Likewise, it is not true that FCC rules preserving State flexibility would increase the FCC's burden by forcing the agency to determine whether particular State policies are consistent with the requirements of Sections 251 and 252 on a case-by-case basis.[3/] FCC rules which establish standards on core matters and defer to State regulators on all other matters would not require the Commission to further adjudicate disputes concerning those other matters since State regulators would have delegated authority to act on those issues.

AT&T acknowledges that varying local conditions require that Sections 251 and 252 be interpreted differently in different states and for different LECs. However, AT&T's proposal to care for widely varying local conditions is to create new Federal rules for

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[2/] AT&T Comments at 7; Justice Dept. Comments at 9-10.

[3/] AT&T Comments at 9-11.

different categories of LECs and to allow State regulators to petition for waivers of those rules.[4/] That approach is needlessly complex. Given the complexity of the task and the time required to properly analyze the options, it is not reasonable to expect the Commission to assess and adopt such rules by the August 8 deadline. This is because adopting explicit and detailed rules that attempt to account for widely varying local circumstances would require the Commission to consider and resolve numerous technical, economic, and demographic variables. State commissions are better equipped to manage and account for those varying local conditions.

While there is no sound reason to adopt Federal rules that substantially eliminate State discretion to interpret Sections 251 and 252 to meet local conditions, there are sound reasons to adopt Federal rules that preserve State discretion as the initial comments show. First, the adoption of Federal rules that eliminate State discretion inevitably would slow, not speed, the development of competition in states like Connecticut where State regulators already have adopted policies designed to open the exchange market to competition. For example, SNET showed in its comments that the Connecticut Department of Public Control ("DPUC") already has authorized 10 companies to provide exchange service in competition with SNET, and that the DPUC has adopted policies dealing with many of the matters covered by Sections 251 and 252, including (i) network interconnection points, (2) network element unbundling

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[4/] AT&T Comments at 12-13.

requirements (including pricing), (3) physical collocation requirements, (4) reciprocal compensation requirements, (5) number portability, and (6) in-state toll equal access requirements.[5/] Federal rules that remove State flexibility to meet local conditions obviously could not accommodate the different approaches that different states have taken on these matters and thus would slow the development of competition by requiring new negotiations and new regulatory proceedings in order to implement the FCC's detailed requirements.

Vesting significant responsibility to States to interpret Sections 251 and 252 also frees the FCC to focus on other important issues. Adopting this approach likewise is clearly less regulatory and will reduce the burden of compliance for all parties. Further, State commissions, because of their local focus and state-specific expertise, can resolve issues more expeditiously, a benefit to LECs and competitors alike.

II. Prices for a LEC's Unbundled Network Elements Should Be Based on TSLRIC and Should Include a Reasonable Contribution to Common Costs

Requiring LECs to set the price of unbundled network elements and interconnection arrangements at incremental cost as some CLECs propose is unlawful. First, it would be an unlawful taking under the Fifth Amendment since it would be tantamount to prohibiting LECs from recovering common costs, including embedded common costs. Requiring LECs to set prices at incremental cost is also inconsistent with the requirement in Sections 251 and 252 that prices be

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5/ SNET Comments at 7-11.

set through "private negotiation and subject to "[d]eterminations by a State commission . . ." (emphasis added). Such an approach is also inconsistent with FCC precedent. The Commission has repeatedly held that all services offered by LECs should be set at a level which allows those services to make a reasonable contribution to the LEC's common costs.

Requiring that LECs price unbundled network elements and interconnection arrangements at incremental cost also would be unfair as a matter of equity and inconsistent with the competitive model. If a LEC must allow competitors to use its network to compete with the LEC, equity requires that the competitor bear a reasonable portion of the total costs of that network. Otherwise, competitors will be given an incentive to make uneconomic choices for interconnection and will have no incentive to construct their own facilities, a major goal of the Act. Pricing at incremental cost also is inconsistent with the competitive model which the Act and the Commission seek to foster because competitive firms set their prices based on market conditions using incremental cost as a floor. While no individual service must recover common costs, in the aggregate all common costs must be recovered by the firm.

While the Commission should not require LECs to price interconnection arrangements and unbundled network elements at incremental cost, it may appropriately instruct State regulators to use incremental price studies as a price floor. But the Commission also must ensure that State regulators have authority to permit

LECs to set prices for unbundled network elements at prices which include a reasonable share of the LEC's common costs.

The Connecticut DPUC already has taken this approach. It has held that SNET is entitled to set the price of its unbundled network elements and interconnection arrangements at a level which allows SNET to recover its costs (defined as TSLRIC) plus contribute to SNET's common costs. Moreover, SNET already has provided the DPUC with testimony identifying the level of common costs which must be recovered. These costs include not only administrative common costs like accounting, human resources and legal, but also SNET's operational support systems. These systems are used throughout the network and cannot be directly attributed to any specific product or product group.

III. The Commission Should Develop Guidelines to Help State Regulators Determine, In Applying Section 251(f)(2), If Particular Provisions In Sections 251(b) or 251(c) Will Adversely Affect Companies With Less than Two Percent of the Nation's Access Lines

Several commenters joined SNET in offering suggestions on how the Commission may clarify Section 251(f)(2) in ways that would be helpful.[6/] That provision applies to LECs with fewer than two percent of the nation's telephone access lines. It requires State regulators to relieve a LEC of that type from a duty to comply with a requirement of Sections 251(b) or 251(c) if doing so is in the public interest.

[6/] SNET Comments at 35-38; Lincoln Tel. Co. Comments at 22-25; Cincinnati Bell Comments at 39-42.

While several commenters offered helpful suggestions for ways to clarify this provision, one commenter, AT&T, suggested a clarification that is inconsistent with the plain meaning of this provision. According to AT&T, the Commission should hold that a LEC to whom Section 251(f)(2) applies is entitled to relief under this provision only if the LEC shows that enforcement of the requirement at issue would cause substantially more harm to that LEC and its customers than would enforcement of the requirement against large LECs.[7/] While Section 251(f)(2) requires a small LEC to show that it or its customers will be harmed in order to obtain relief, nothing in this provision can be read to require that the petitioning LEC also must prove that this harm outweighs the harm that will result to large LECs. Instead, Section 251(f)(2) assumes as a matter of law that compliance with Sections 251(b) and 251(c) will be more burdensome for small LECs than for large LECs, and it provides a mechanism for granting relief if a small LEC shows that the burden is significant.

IV. The Commission Should Not Allow the Use of Interconnection and Unbundled Network Elements To Avoid Access Charges

SNET urges the Commission to make good on its promise when this proceeding began to reform the way in which LECs price interstate access service. Those rules require that a LEC charge substantially more for connections to the LEC's local network for the provision of interexchange service than is justified on

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7/ AT&T Comments at 92-93.

economic grounds. The rules require that interstate access be overpriced in order to subsidize other services.

Reforming the access charge pricing rules is essential in order to avoid arbitrage. A LEC's true economic cost of interconnecting with the facilities of an exchange service competitor is substantially similar to its true economic cost of interconnecting with the facilities of an interexchange carrier. Yet the Commission's access rules require that interstate access be priced considerably above its true economic cost and that other services be priced below cost.

While the Commission should reform its access pricing rules promptly, it cannot lawfully do so in this proceeding by requiring that LECs provide interconnection and unbundled network elements to interexchange carriers at the cost-based rate contemplated in Sections 251 and 252 without also providing a specific mechanism by which the resulting unrecovered costs can be recovered. Requiring LECs to lower interstate access rates without also providing a mechanism that permits them to recover the remaining costs would raise serious questions of confiscation of property in violation of the Fifth Amendment, and it would be unlawful under the Telecommunications Act of 1996.

Rather than seeking to "reform" interstate access pricing rules in this proceeding by requiring LECs to lower access prices without providing a method by which the remaining costs can be recovered, the Commission instead must couple access pricing reform with substantive changes to the Commission's price cap rules,

universal service reform, and rate rebalancing. Without that, LECs will not have a reasonable opportunity to compete, and consumers will be denied the benefits of real competition.

IV. Reasonable Restrictions on Resale -- Including Restrictions on the Resale of Service Packages, Promotions and Discount Plans -- Are Permitted by the Act

Reasonable restrictions on the requirement in Section 251(c)(4) to provide resellers with retail services at wholesale are both consistent with the Act and are in the public interest. SNET and others have correctly argued that a requirement to provide discounted rate plans, service packages, and promotional offerings at wholesale rates will harm the very competition which the Act intends to create by stifling innovation and competition in the discount rate plan and service packaging markets.

While AT&T claims that Section 251(c)(4) requires LECs to offer all retail services at a wholesale price, it is wrong.[8/] By its express terms, this statutory provision allows restrictions on resale that are not "unreasonable or discriminatory."

Not only does Section 251(c)(4) expressly authorize reasonable conditions on a LEC's duty to provide resellers with retail services at a wholesale price, SNET's comments identified two specific conditions which are reasonable, and nothing in the initial comments of other parties demonstrates that these two conditions are unreasonable.

First, SNET urged the Commission to give State regulators discretion to exempt a LEC from the obligation to provide a service

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[8/] AT&T Comments at 77.

at wholesale whose retail price is below cost when State regulators conclude that doing so would substantially increase the LEC's losses in providing that service.[9/] NCTA appears to agree with SNET that a condition of this type is reasonable since it would "prevent[] unfair arbitrage of services that are . . . . provided to the reseller below cost."[10/] NCTA also notes that such arbitrage not only would be unfair to the LEC, it also could slow the development of meaningful exchange competition by "significantly reduc[ing] economic incentives for [exchange] competitors to invest in their own facilities.[11/]

In order to avoid harming competition in the offering of discounted rate plans or service packages, SNET also urged the Commission to give State regulators discretion to exempt a LEC from the obligation to provide discounted rate plans and service packages at wholesale if the service(s) upon which the plan or package is based already is (are) available for resale.[12/] Numerous commenters agree with SNET that requiring resale of discounted rate plans or service packages in these circumstances

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9/ SNET Comments at 31-32.

10/ NCTA Comments at 57. MFS makes a similar point by stating that it may be appropriate to exempt services of this type from the resale requirements in Section 251(c)(4) in order "to prevent arbitrage through resale of a subsidized service to customers who do not qualify for the subsidy." MFS Comments at 70-71.

11/ NCTA Comments at 57.

12/ SNET Comments at 32-33. For identical reasons, SNET also urged the Commission to give state regulators discretion to exempt a LEC from providing resellers with promotional and market trial offerings at wholesale. Id. at 34.

would discourage competition in the discounted rate plan and service package market.[13/] By contrast, no commenter -- including none who want the right to obtain discounted rate plans and service packages at wholesale -- disagrees that the result would be to frustrate competition in these markets.

While implicitly acknowledging that competition in the discounted rate plan and service packaging markets would be damaged if these services are subject to the wholesale pricing requirement, those who support a wholesale pricing requirement argue that the resulting damage to competition is outweighed by the alleged benefits that would result from making these services available at wholesale. But no commenter attempts to identity these alleged benefits in any concrete way. For example, several commenters claim that requiring these services to be provided at wholesale will ensure that CLECs have access to all retail services they need in order to provide a full package of retail services to consumers. But SNET proposes to exempt service packages and discount plans from the wholesale requirement only when the underlying services are available at wholesale. This would ensure that CLECs have access to all retail services they need in order to provide a full package of services to consumers without giving them guaranteed access at wholesale to the LEC's service packages and discounted rate plans.

[13/] See, e.g., Comments of SBC Corp at 72-73; Comments of Lincoln Tel. Co. at 19; Comments of GTE at 49.

While MFS also does not attempt to identify any specific benefits that would result from requiring LECs to provide discounted rate plans and packages at wholesale, it seeks to justify imposing such a requirement by contending that the FCC already has held in adopting its interstate service resale policy that all restrictions on volume discounts and service packages are unreasonable as a matter of law regardless of the benefits.[14] In fact, the FCC has never made any findings about the benefits and risks associated with a requirement to provide discounted rate plans and service packages to resellers at wholesale. Instead, the agency has held only that it is unreasonable as a matter of law to restrict the provision of such services to resellers at retail. This FCC finding is unobjectionable. Providing such services to resellers at retail poses little risk, but a requirement to provide these services at wholesale risks damaging competition in the discount rate plan and service packaging markets.[15]

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[14] MFS Comments at 70.

[15] SNET has filed a petition with the DPUC seeking suspension of Section 251(c)(4) to allow it to resell its local exchange service to CLECs at rates based on Total Service Long Run Incremental Costs (TSLRIC) plus a reasonable contribution to overhead costs unless or until such time as retail residential rates cover costs plus provide a reasonable contribution.

CONCLUSION

Several States have taken the initiative to open their exchange markets to competition before the Telecommunications Act of 1996 was even enacted. These States, including Connecticut, have considered the same issues raised in the present proceeding, and they have debated the various options to resolve these issues. The Commission should rely on these experiences in determining what its role should be, how the negotiation process should be structured, and how the States should be involved in resolving issues that affect their local economic and social areas of responsibility. The Connecticut experience is available to the Commission as it examines the implications of national guidelines. That experience shows that Connecticut regulators have attempted to balance the new competitive landscape and that, given authority, they can help the Commission implement the spirit of the 1996 Act as well.

SNET has argued for a strong role for State regulators since they are uniquely situated to quickly implement the procompetitive policies of the Act. SNET urges the Commission to propose a minimum set of rules for implementing Sections 251 and 252 and delegate much of the responsibility to implement these provisions to the States. Further, SNET proposes that the FCC specifically ratify all State orders that are not inconsistent with the Act's plain language. If the Commission requires evidence that a State's

order complies with the Act, it should authorize State commissions to certify compliance.

Respectfully submitted,

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